



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**

SEC FILE NUMBER
66670

FACING PAGE

**Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder**

REPORT FOR THE PERIOD BEGINNING 01/01/07 AND ENDING 12/31/07
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Heritage Financial Systems, Inc.

OFFICIAL USE ONLY
FIRM I.D. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

2 West Liberty Boulevard, Suite 203

(No. and Street)

Malvern

PA

19355

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Morison Cogen LLP

(Name - if individual, state last, first, middle name)

150 Monument Road, Suite 500 Bala Cynwyd

(Address)

(City)

PA

(State)

19004

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant

☐ Public Accountant

☐ Accountant not resident in United States or any of its possessions.

PROCESSED

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*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

SEC 1410 (06-02)

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JD
3/24/08

OATH OR AFFIRMATION

I, Brian Lureen, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Heritage Financial Systems, Inc., as of December 31, 20 07, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

Brian K. Lureen

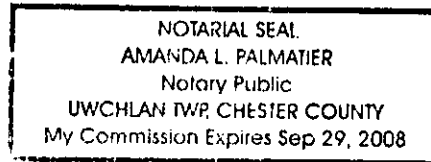
Signature

President & CEO

Title

Amanda L. Palmatier

Notary Public



This report ** contains (check all applicable boxes):

- ☒ (a) Facing Page.
- ☒ (b) Statement of Financial Condition.
- ☒ (c) Statement of Income (Loss).
- ☒ (d) Statement of Changes in Financial Condition.
- ☒ (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
- ☐ (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (g) Computation of Net Capital.
- ☐ (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☐ (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☐ (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☐ (l) An Oath or Affirmation.
- ☐ (m) A copy of the SIPC Supplemental Report.
- ☐ (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)

FINANCIAL STATEMENTS

DECEMBER 31, 2007 AND 2006

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)

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INDEPENDENT AUDITORS' REPORT

To the Stockholder
Heritage Financial Systems, Inc.
Malvern, Pennsylvania

We have audited the accompanying statements of financial condition of Heritage Financial Systems, Inc. (a wholly-owned subsidiary of Heritage Fincorp, Inc.) as of December 31, 2007 and 2006, and the related statements of operations and comprehensive income (loss), changes in stockholder's equity and cash flows for the years then ended that you are filing pursuant to Rule 17a-5 under the Securities Exchange Act of 1934.

These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Heritage Financial Systems, Inc. at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The information contained in the supplementary schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements, but is supplementary information required by Rule 17a-5 of the Securities Exchange Act of 1934. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements, and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



February 26, 2008

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 12,961	\$ 25,774
Commissions receivable	48,763	251,455
Receivable from broker-dealers	<u>5,795</u>	<u>6,085</u>
	67,519	283,314
INVESTMENT	82,277	74,222
PROPERTY AND EQUIPMENT, Net	2,288	4,926
SECURITY DEPOSIT	<u>-</u>	<u>4,855</u>
TOTAL ASSETS	<u><u>\$ 152,084</u></u>	<u><u>\$ 367,317</u></u>
LIABILITIES		
CURRENT LIABILITIES		
Line of credit	\$ 35,000	\$ 35,000
Accounts payable and accrued expenses	<u>50,042</u>	<u>52,750</u>
TOTAL LIABILITIES	<u>85,042</u>	<u>87,750</u>
STOCKHOLDER'S EQUITY		
COMMON STOCK - 1,000 shares authorized, issued and outstanding	25,000	25,000
ADDITIONAL PAID-IN CAPITAL	208,835	178,835
ACCUMULATED OTHER COMPREHENSIVE INCOME	22,835	14,780
RETAINED EARNINGS (DEFICIT)	<u>(189,628)</u>	<u>60,952</u>
TOTAL STOCKHOLDER'S EQUITY	<u>67,042</u>	<u>279,567</u>
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	<u><u>\$ 152,084</u></u>	<u><u>\$ 367,317</u></u>

The accompanying notes are an integral part of these financial statements.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
REVENUE		
Commissions and other income	\$ 925,801	\$ 1,022,470
Management fees	<u>169,128</u>	<u>130,798</u>
	<u>1,094,929</u>	<u>1,153,268</u>
OPERATING EXPENSES	<u>1,205,250</u>	<u>966,507</u>
OTHER INCOME (EXPENSE)		
Interest income	232	209
Interest expense	<u>(7,491)</u>	<u>(6,305)</u>
	<u>(7,259)</u>	<u>(6,096)</u>
NET INCOME (LOSS)	(117,580)	180,665
OTHER COMPREHENSIVE INCOME		
Unrealized holding gain arising during year	<u>8,055</u>	<u>6,500</u>
COMPREHENSIVE INCOME (LOSS)	<u><u>\$ (109,525)</u></u>	<u><u>\$ 187,165</u></u>

The accompanying notes are an integral part of these financial statements.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY
YEARS ENDED DECEMBER 31, 2007 AND 2006

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings (Deficit)	Total Stockholder's Equity
BALANCE - JANUARY 1, 2006	\$ 25,000	\$ 135,844	\$ 8,280	\$ (41,713)	\$ 127,411
CONTRIBUTED CAPITAL	-	42,991	-	-	42,991
DISTRIBUTIONS	-	-	-	(78,000)	(78,000)
OTHER COMPREHENSIVE INCOME Unrealized holding gain arising during year	-	-	6,500	-	6,500
NET INCOME FOR THE YEAR ENDED DECEMBER 31, 2006	-	-	-	180,665	180,665
BALANCE - DECEMBER 31, 2006	25,000	178,835	14,780	60,952	279,567
CONTRIBUTED CAPITAL	-	30,000	-	-	30,000
DISTRIBUTIONS	-	-	-	(133,000)	(133,000)
OTHER COMPREHENSIVE INCOME Unrealized holding gain arising during year	-	-	8,055	-	8,055
NET LOSS FOR THE YEAR ENDED DECEMBER 31, 2007	-	-	-	(117,580)	(117,580)
BALANCE - DECEMBER 31, 2007	\$ 25,000	\$ 208,835	\$ 22,835	\$ (189,628)	\$ 67,042

The accompanying notes are an integral part of these financial statements.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (117,580)	\$ 180,665
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	2,638	2,610
(Increase) decrease in assets		
Commissions receivable	202,692	(181,854)
Receivable from broker-dealer	290	1,389
Security deposit	4,855	-
Increase (decrease) in liabilities		
Accounts payable and accrued expenses	<u>(2,708)</u>	<u>13,361</u>
Net cash provided by operating activities	<u>90,187</u>	<u>16,171</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of fixed assets	<u>-</u>	<u>(2,065)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Additional paid-in capital	30,000	42,650
Distributions to stockholder	<u>(133,000)</u>	<u>(78,000)</u>
Net cash used in financing activities	<u>(103,000)</u>	<u>(35,350)</u>
NET DECREASE IN CASH	(12,813)	(21,244)
CASH - BEGINNING OF YEAR	<u>25,774</u>	<u>47,018</u>
CASH - END OF YEAR	<u>\$ 12,961</u>	<u>\$ 25,774</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
CASH PAID DURING THE YEAR FOR:		
Interest	<u>\$ 7,491</u>	<u>\$ 6,305</u>

The accompanying notes are an integral part of these financial statements.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Formation and Nature of Operations

Heritage Financial Systems, Inc. (the company), established in 1999, is a broker-dealer registered with the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) (formerly the NASD). The company specializes in financial planning and consulting.

The company, effective September 9, 2006, became a wholly-owned subsidiary of Heritage Fincorp, Inc. This transaction was accounted for at historical cost.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the use of estimates based on management's knowledge and experience. Accordingly, actual results could differ from those estimates.

Commissions Receivable and Receivable from Broker-dealers

Commissions are recognized as income on a trade-date basis as they become payable by the financial institution. Management deems all receivable to be fully collectible. Accordingly, no allowance for bad debts is considered necessary.

Investment

The company's investment in a variable universal life policy is recorded at fair value.

Depreciation

The cost of property and equipment is depreciated over the estimated useful lives of the related assets. Depreciation is computed using straight-line and accelerated methods.

Advertising

Advertising costs, except for costs associated with direct-response advertising, are charged to operations when the advertising first takes place. The costs of direct-response advertising are capitalized and amortized over the period during which future benefits are expected to be received.

"S" Election

The company has elected by consent of its stockholder to be taxed under the provisions of Subchapter S of the Internal Revenue Code and the Commonwealth of Pennsylvania. Under those provisions, the company does not pay federal and state corporate income taxes on its taxable income. Instead, the stockholder is liable for individual federal and state income taxes on its respective share of the company's taxable income.

Comprehensive Income (Loss)

The company follows Statement of Financial Accounting Standards (SFAS) 130, *Reporting Comprehensive Income*. Comprehensive income (loss) is a more inclusive financial reporting methodology that includes disclosures of certain financial information that historically has not been recognized in the calculation of net income (loss).

NOTE 2 – CONCENTRATION OF CREDIT RISK

During the year the company may have deposits with major financial institutions, which exceed Federal Depository Insurance limits. These financial institutions have strong credit ratings, and management believes the credit risk related to these deposits is minimal.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006

NOTE 2 – CONCENTRATION OF CREDIT RISK (continued)

The company is engaged in various trading and brokerage activities in which counterparties primarily include broker-dealers, banks, and other financial institutions. In the event the counterparties do not fulfill their obligations, the company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument.

NOTE 3 – PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

	<u>2007</u>	<u>2006</u>
Office equipment	\$ 33,396	\$ 33,396
Furniture	<u>33,332</u>	<u>33,332</u>
	66,728	66,728
Less: Accumulated depreciation	<u>64,440</u>	<u>61,802</u>
	<u>\$ 2,288</u>	<u>\$ 4,926</u>

Depreciation expense for the years ended December 31, 2007 and 2006 was \$2,638 and \$2,610.

NOTE 4 – NET CAPITAL

The company is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC Rule 15c3-1), which requires the maintenance of a minimum net capital, as defined under such provision. Net capital may fluctuate on a daily basis. The company had net capital as defined under Rule 15c3-1 of \$15,879 at December 31, 2007; net capital requirements were \$5,669 at December 31, 2007.

NOTE 5 – LINE OF CREDIT

The company has a line of credit with a maximum of \$35,000 with a financial institution, which bears interest at 8.25% and expires December 2049. The line is collateralized by all inventory, chattel paper, accounts, equipment, and general intangibles, and is personally guaranteed by the president of the parent company. Outstanding borrowings under the line were \$35,000 as of December 31, 2007 and 2006.

NOTE 6 – LEASES

For the years ended December 31, 2007 and 2006, total rental expense under leases amounted to \$31,309 and \$67,976. Effective July 2007, the company moved office facilities in which the lease is in the name of the company's parent.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2007 AND 2006

NOTE 7 – RELATED PARTIES

Effective September 2006, the Company has been providing administrative services to other entities that are affiliated by common ownership and other subsidiaries of the parent. Fees received for management services were \$169,128 and \$130,798 for the years ended December 31, 2007 and 2006.

The company is provided administrative services from other entities that are affiliated by common ownership and other subsidiaries of the parent. Fees paid for management services were \$264,078 for the year ended December 31, 2007.

HERITAGE FINANCIAL SYSTEMS, INC.
(a wholly-owned subsidiary of Heritage Fincorp, Inc.)
COMPUTATION OF NET CAPITAL UNDER RULE 15c3-1 OF THE
SECURITIES AND EXCHANGE COMMISSION
AS OF DECEMBER 31, 2007

CAPITAL AND ALLOWABLE SUBORDINATED LIABILITIES	
Total stockholder's equity qualified for net capital	<u>\$ 67,042</u>
DEDUCTIONS	
Non-allowable assets:	
Receivables from non-brokerage customers	48,763
Fixed assets, net of accumulated depreciation	2,288
Haircuts on securities	112
	<u>51,163</u>
NET CAPITAL	<u><u>\$ 15,879</u></u>
AGGREGATE INDEBTEDNESS	
Items included in statement of financial condition:	
Accounts payable and accrued expenses	\$ 50,042
Line of credit	35,000
	<u>85,042</u>
Total aggregate indebtedness	<u><u>\$ 85,042</u></u>
COMPUTATION OF BASIC NET CAPITAL REQUIREMENT	
MINIMUM NET CAPITAL REQUIRED: (BASED ON AGGREGATE INDEBTEDNESS)	<u><u>\$ 5,669</u></u>
MINIMUM DOLLAR NET CAPITAL REQUIREMENT OF REPORTING DEALER	<u><u>\$ 5,000</u></u>
NET CAPITAL REQUIREMENT	<u><u>\$ 5,669</u></u>
EXCESS NET CAPITAL	<u><u>\$ 10,210</u></u>
RATIO: AGGREGATE INDEBTEDNESS TO NET CAPITAL	<u><u>5.36</u></u>

The Form X-17a-5 reconciliation is not included as there are no material differences from the company's computation.

An exemption from SEC Rule 15c3-3 is claimed under section (k)(2)(ii) of SEC Rule 15c3-3.

**INDEPENDENT AUDITORS' REPORT
ON INTERNAL CONTROL STRUCTURE REQUIRED BY
SEC RULE 17a-5 FOR A BROKER-DEALER CLAIMING
AN EXEMPTION FROM SEC RULE 15c3-3**

Board of Directors
Heritage Financial Systems, Inc.
Malvern, Pennsylvania

In planning and performing our audit of the financial statements and supplemental schedule of Heritage Financial Systems, Inc. (a wholly-owned subsidiary of Heritage Fincorp, Inc.) as of and for the year ended December 31, 2007, in accordance with auditing standards generally accepted in the United States of America, we considered the company's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control. Accordingly, we do not express an opinion on the effectiveness of the company's internal control.

Also, as required by rule 17a-5(g)(1) of the Securities and Exchange Commission (SEC), we have made a study of the practices and procedures followed by the company including consideration of control activities for safeguarding securities. This study included tests of such practices and procedures that we considered relevant to the objectives stated in rule 17a-5(g) in making the periodic computations of aggregate indebtedness (or aggregate debts) and net capital under rule 17a-3(a)(11) and for determining compliance with the exemptive provisions of rule 15c3-3. Because the company does not carry securities accounts for customers or perform custodial functions relating to customer securities, we did not review the practices and procedures followed by the company in any of the following:

1. Making quarterly securities examinations, counts, verifications, and comparisons and recordation of differences required by rule 17a-13;
2. Complying with the requirements for prompt payment for securities under Section 8 of Federal Reserve Regulation T of the Board of Governors of the Federal Reserve System.

The management of the company is responsible for establishing and maintaining internal control and the practices and procedures referred to in the preceding paragraph. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the SEC's above-mentioned objectives. Two of the objectives of internal control and the practices and procedures are to provide management with reasonable but not absolute assurance that assets for which the company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States. Rule 17a-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of inherent limitations in any internal control structure or the practices and procedures referred to above, error or fraud may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk that they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

A *control deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliability in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A *material weakness* is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first and second paragraphs and would not necessarily identify all deficiencies in internal control that might be material weaknesses. We did not identify any deficiencies in internal control and control activities for safeguarding securities that we consider to be material weaknesses, as defined above.

We understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the SEC to be adequate for its purposes in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate a material inadequacy for such purposes. Based on this understanding and on our study, we believe that the company's practices and procedures were adequate at December 31, 2007 to meet the SEC's objectives.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, FINRA, and other regulatory agencies that rely on rule 17a-5(g) under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and is not intended to be and should not be used by anyone other than these specified parties.

 Morrison Cogen LLP

February 26, 2008

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of Morison International